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No. 82-2091

IN THE
Supreme Court of the United States
OCTOBER TERM, 1982

SHEARN MOODY, JR.,
Petitioner,
v.
DAVID C. MEYERS, *et al.*,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

MOTION FOR LEAVE TO FILE A BRIEF *AMICUS CURIAE* OF THE WASHINGTON LEGAL FOUNDATION AND BRIEF OF *AMICUS CURIAE* THE WASHINGTON LEGAL FOUNDATION IN SUPPORT OF AFFIRMANCE

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MOTION OF THE WASHINGTON LEGAL FOUNDATION FOR LEAVE TO FILE A BRIEF *AMICUS CURIAE*

The Washington Legal Foundation hereby moves this Court pursuant to Supreme Court Rules 36.1 and 42.2(b), for leave to file the annexed brief *amicus curiae* in support of the Petition for Writ of Certiorari in the above captioned proceeding. Consent to the filing of this brief has been granted by counsel for petitioner. Counsel for respondent has been contacted and has withheld consent.

The Washington Legal Foundation (WLF or Foundation) is a national non-profit public interest law center that engages in litigation and the administrative process in matters affecting the broad public interest. WLF has more than 85,000 members throughout the United States whose interests the Foundation represents.

WLF participates in and has devoted a substantial portion of its resources to cases relating to government regulation, judicial procedure, and constitutional law involving the rights of citizens and businesses. WLF has appeared in the United States Supreme Court on many occasions as *amicus curiae*. *See, e.g., Consolidated Edison Co. of New York v. Public Service Commission of the State of New York*, 447 U.S. 530 (1980); *United Steel Workers v. Weber*, 443 U.S. 193 (1979); *Carbon Fuel Co. v. United Mine Workers*, 442 U.S. 939 (1979); *Personnel Administrator of Mass. v. Feeney*, 442 U.S. 256 (1979); *Parklane Hosiery Co. v. Shore*, 439 U.S. 322 (1979); and *Federal Trade Commission v. Standard Oil Co. of California*, 449 U.S. 232 (1980). More significantly, WLF filed, and the Court accepted over opposition, a brief *amicus curiae* in support of the petition for writ of certiorari in *Moody v. Forresster*, No. 80-1235 (US. filed Feb. 20 1981), *cert. denied*, 450 U.S. 1026 (1981), and *Moody v. State of Alabama ex rel. Tharpe Forresster*, No. 82-740 (U.S. filed Oct. 28, 1982), *cert. denied*, 51 U.S.L.W. 3612 (U.S. Feb. 22, 1983). These cases arose out of the same facts and circumstances as the instant one although the issues here are different. In addition, WLF has recently published a relevant monograph, F. Newman, *Insurance: Is It Overregulated?* (1982).

WLF believes that as a matter of law and policy, the Fifth Circuit's decision merits this Court's review and reversal not only for the seriousness of its legal errors but for the extremely adverse consequences that such decision will have on not only the petitioner, but also the

insurance industry, regulated industries as a whole, and consumers.

WLF submits that the decision below is clearly contrary to the public interest and accordingly, requests that it be permitted to participate as *amicus curiae* in this matter.

Respectfully submitted,

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INTERESTS OF THE *AMICUS CURIAE* WASHINGTON LEGAL FOUNDATION

The interests of *amicus curiae* Washington Legal Foundation (WLF or Foundation) are set forth in the foregoing motion for leave to file a brief *amicus curiae.*

STATEMENT OF THE CASE

In the interests of judicial economy, *amicus* hereby adopts by reference the Statement contained in the Petition for Writ of Certiorari at 2-6. Nevertheless, *amicus* believes it is warranted and useful to recount certain facts that highlight the significance of the issues to be resolved.

Petitioner incorporated Empire Life Insurance Company ("Empire") in 1963 in the State of Alabama and became its president, board chairman, and majority shareholder. Subsequently, he transferred to Empire a 40 per

cent share of his life interest in the Libbie Shearn Moody Trust. The valuation of this asset of Empire, as well as any other asset of any insurance company, is the statutory responsibility of the appropriate state Department of Insurance. The primary purpose of the asset valuation by the Department of Insurance is to assure that the insurance companies are economically sound to protect policyholders. The asset valuation process and the judicial review of that process are the underlying issues in the case at bar.

In this case, the Superintendent of Insurance for Alabama, in accordance with his statutory authority, had placed the following values on the life interest asset of Empire:

1964: $ 5,813,440
1965: $14,213,440
1969: $14,213,440
1972: $ 4,250,000

Because of the $14.2 million valuation placed on the asset in 1965, Empire acquired interests in other companies and expanded its business. These mergers and acquisitions were reviewed and approved by the Alabama Department of Insurance. To this day, there have never been any direct challenges, either administratively or judicially, to the orders of the Department of Insurance placing the $14 million value on the asset or approving the mergers.

However, because of the devaluation of the life interest by the Department of Insurance in 1972 to an amount of $4,250,000, Empire was immediately declared to be insolvent under statutory accounting principles and placed into receivership on June 29, 1972. Shortly thereafter, attorneys were hired by the Receiver at an hourly plus contingent fee to be paid from a $2 million fund set aside from Empire's assets and from the recovery of any claims prosecuted.

The instant lawsuit was filed by the Receiver on behalf of Empire against its founder Shearn Moody in June, 1974 alleging that Mr. Moody violated federal securities law and mismanaged the company because the acquisitions he made *before* 1972 were unreasonable because the asset, upon which the acquisitions were made, should not have been valued at $14.2 million even though it was so valued by the Superintendent of Insurance. Thus, the present Receiver contends that the revaluation of life interests to $14.2 million by the former receiver was erroneous and that Mr. Moody should be personally liable as a result.

The case was tried in December, 1976 and although the jury found that the policyholders suffered *no* injury because of Mr. Moody's alleged mismanagement, they awarded damages against him for over $6 million. On May 29, 1979, the district court entered judgment against petitioner for $6,319,000 with pre-judgment interest at 6 percent accruing from at least July 1, 1972, the date of the Receivership. Pet. App. 78. Thus, the amount accrued to date exceeds $10 million, not a cent of which is owed to any policyholders of Empire since all obligations to pay them have already been satisfied. The Court of Appeals affirmed, creating out of thin air a new rule of insurance law that, notwithstanding the regulation of the insurance industry by the states and the statutory responsibilities of insurance commissioners in valuating assets and approving mergers, a federal court can *de novo* make its own valuations of assets and hold company officials personally liable for not operating a business on the basis of those judicially determined valuations.

The result of this case is that Mr. Moody has had his once valuable interest suddenly declared to be almost worthless and his company thereby declared statutorily insolvent. The assets of his company, once transferred to the Receiver, were then used to hire counsel at an hourly plus contingent fee rate to sue Mr. Moody and

hold him personally liable retroactively for over $6 million. Further, the alleged injury stemming from acquisitions approved by the proper state authorities in the first place, run not to any company policyholder, but presumably to the company itself which Mr. Moody founded.

REASONS FOR GRANTING THE WRIT

The decision of the court of appeals is truly mind-boggling. Not only is it a gross miscarriage of justice for the petitioner, but the decision does great violence to the concept of federalism, runs roughshod over the legal principles enunciated by this Court in *Erie Railroad Co. v. Tompkins*, 304 U.S. 64 (1938), conflicts with decisions in other circuits, will open the floodgates to litigation in federal courts already straining from overloaded dockets, and has the real potential for creating great economic havoc with the multibillion dollar insurance industry to the detriment of consumers and the economy.

Amicus submits that the Fifth Circuit "has so far departed from the accepted and usual course of judicial proceedings, or so far sanctioned such a departure by a lower court, as to call for an exercise of this Court's power of supervision." Supreme Court Rule 17.1(a). *Amicus* further submits that the underlying legal issues of this case are appropriately postured for this Court's review after a decade of litigation, and thus especially warrant this Court's consideration.

I. THE DECISION BELOW IMPERMISSIBLY PERMITS FEDERAL COURTS TO INTERVENE INTO STATE REGULATORY MATTERS AND IS NOT IN THE PUBLIC INTEREST

The Fifth Circuit's decision completely ignored the rights and duties of the states, through their respective insurance commissioners and local courts, to regulate insurance companies. Federal legislation policy recognizes that the regulation of the business of insurance by the states "is in the public interest." 15 U.S.C. 1011

(McCarran-Ferguson Act). It is also "in the public interest" that the federal courts, as courts of limited jurisdiction, should in the first instance abstain for exercising jurisdiction that has the effect of collaterally attacking decisions made by state regulatory agencies. *Burford v. Sun Oil Co.*, 319 U.S. 315, 318 (1943); *Allstate Insurance Co. v. Sabbagh*, 603 F.2d 228 (1st Cir. 1979); *Smith v. Metropolitan Property & Liability Insurance Co.*, 629 F.2d 757 (2d Cir. 1980).

In the second instance, if the federal courts are allowed to exercise their limited jurisdiction and intrude into matters of state regulation, they are required to apply state law to the state law claims. *Erie Railroad Co. v. Tompkins*, 304 U.S. 64 (1938). In this case, however, the Fifth Circuit failed to pay even lip service to the laws of Texas or Alabama regarding the valuation of assets of insurance companies, and instead engaged in lawmaking of its own. By doing so, the court recklessly cast aside fundamental principles of federalism and comity, as well as basic principles of the finality of agency decisions by permitting a collateral attack on those decisions.

As indicated in petitioner's writ of certiorari, collateral attacks on an agency's decision, such as the attack here on the decision valuating the asset of Empire at $14.2 million, are clearly forbidden under Texas and Alabama law. *See* Petition at 13, 18, n. 19. Not surprisingly, other states have similar prohibitions against collateral attacks. Consequently, federal courts, when faced with questions such as those presented here, have either abstained from exercising their jurisdiction at all, or if they do exercise jurisdiction they apply state law which invariably prohibits collateral attacks on the decisions or orders of the state agency.

As stated, for example, in *Preferred Risk Mutual Insurance Co. v. Manchester Insurance Indemnity Co.*, 467

F.2d 1230 (7th Cir. 1972), the federal court, citing relevant state law, stated:

> "[The Director of Insurance] is vested with authority to determine whether or not a company is complying with the Statute. . . . Being an executive officer his acts, within the scope of his authority, are not and should not be subject to review by the Courts. Any other rule might result in the Courts substituting their judgment for that of the Director."

467 F.2d at 1233, *quoting Barber, People ex rel. v. Hargreaves*, 303 Ill. App. 287, 25 N.E.2d 416, 420 (1980). Since the $14.2 million valuation had not been directly attacked, it should have been accepted by the lower courts as reasonable. As stated by Professor Davis:

> [W]hen a statutory method of review of administrative action is prescribed by statute, that method probably is always deemed a direct attack. Normally, a challenge of administrative action by injunction, declaratory judgment, certiorari, or mandamus, is deemed a direct attack when no statutory method of review is prescribed. Proceedings that courts have classified as *collateral include suits against private parties for damages*. . . .

2 K. DAVIS, ADMINISTRATIVE LAW TREATISE 18.10 at 613-14 (1958) (emphasis added).

And since the laws of Texas or Alabama prohibit collateral attacks such as that here, the asset valuation must be accepted as binding. Thus, as further noted by Professor Davis:

> Whenever a court holds that an administrative determination is invulnerable to collateral attack the result may be phrased in terms of res judicata: the administrative determination is res judicata for purposes of the proceeding in which the collateral attack is made.

Id. at 612.

The adverse effect of this novel decision on the insurance industry has the real potential of approaching catastrophic proportions. Since the formation of the first life insurance company in Philadelphia in 1759, the number of such companies has slowly grown to approximately 2,000. American Council of Life Insurance, 1982 LIFE INSURANCE FACT BOOK 88 (hereinafter "1982 FACT BOOK")[1] These life insurance companies have assets that have been valued in excess of $525 *billion* and employ an estimated 1.9 million persons. Some 150 million policyholders in the country own some form of life insurance. It should be remembered that these figures only reflect the characteristics of the life insurance industry and do not include the multi-billion-dollar automobile, casualty, health, and other liability insurance industries.

The primary responsibility for regulation of an industry of this magnitude has been carefully developed by the states over the last two centuries as recognized by the U.S. Congress and this Court. *See SEC v. National Securities Inc.*, 393 U.S. 453, 458-59 (1969). Each state has an appropriate insurance commissioner or superintendent whose statutory responsibility is to ensure that the insurance companies comply with state law regarding their financial affairs.

One of the primary duties of such an agency official is to determine the value of the assets held by the insurance companies to ensure their economic health for the benefit of the policyholders. In this latter respect, it should be noted that life insurance companies have assets of over $40 billion in the miscellaneous asset category, in which the life interest in question here would appear to fall.

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[1] Texas ranks second among the states with the number of life insurance companies domiciled there at over 200. The first is Arizona with over 527. Third is Louisiana at 100. Alabama has 33 life insurance companies, more than twice the number of New Jersey (16), Virginia (14), or Maryland (12), 1982 FACT BOOK at 89.

1982 FACT BOOK 87. Such assets range from real estate ventures to oil, mineral, and timber rights. The value to be placed on these assets, like the life interest in the case at bar, is, as petitioner notes, a mixture of art and science developed by the expertise of those whose job it is to make such valuations, namely, the state insurance commissioners as opposed to federal courts.

After two centuries of reliance on state commissioners' decisions by those affected by the determinations of asset valuation, the Fifth Circuit upsets that reliance and replaces it with extreme uncertainty and instability by exposing insurance company officials to personal liability *retroactively* should a federal court or jury second-guess the determinations of the state commissioner. What the Congress expressly forbade the federal government to do directly by passage of the McCarran-Ferguson Act, the Fifth Circuit has impermissibly sought to do indirectly. By changing the "rules of the game," the Fifth Circuit's decision can only lead to a situation that will harm the policyholders and consumers.

It is clearly in the interests of the consumer for insurance companies to grow and thrive. The more insurance companies there are, the better the competition. As insurance companies are able to expand and acquire income producing assets, the less reliance there is by the company on insurance members as a source, of income, and hence, the greater ability to offer lower cost premiums to the consumer.[2]

If, however, insurance companies can no longer rely on the finality of assets valuations by the state commissioner, but must constantly be concerned that a federal court could years later rule that company officers are personally liable for erroneous asset valuations, the

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[2] Approximately 70 percent of the life insurance companies' income is derived from premiums. Almost 30 per cent is from net investment earnings and other income. 1982 FACT BOOK 61.

prospect of growth is dim at best. Insurance companies would be reluctant to grow or acquire those assets whose valuations may be difficult to determine and subject to change. New companies and investors would be deterred from entering the insurance market because of the unknown liability factor and instability brought about by the intrusion of federal courts into this area. The granting, renewal, and revocation of insurance licenses, certifications of the proper level of capital surplus, compliance with set insurance rates, or the value of a company's holding suddenly become subject to change at any time by the filing of derivative money damage suits against management.

II. THIS COURT SHOULD GRANT REVIEW AND ORDER THE CASE DISMISSED FOR LACK OF JURISDICTION

Amicus supports petitioner's argument that the decision below unjustly permits a duplicative or "windfall" recovery inconsistent with this Court's decision in *Bangor Punta Operations, Inc. v. Bangor & Aroostook Railroad Co*, 417 U.S. 703 (1974) Pet. at 24. If the decision below is allowed to stand, Mr. Moody would be found to be liable for his own loss. A closer analysis of that issue, however, reveals that the respondent is not the real party in interest and that, accordingly, a serious question is presented whether the court below had federal jurisdiction in the first place. *Amicus* submits that both diversity and pendent jurisdiction are lacking.

A. No Diversity Jurisdiction

As noted by petitioner in his petition at (i), "Parties To The Proceedings," the only surviving suit out of the three brought against petitioner is the one filed by John G. Bookout as receiver of Empire against Shearn Moody, Jr., a resident of Texas. Consequently, diversity must stand or fall as of the time that suit was filed, June 28, 1974, and not the other two suits.

However, the Receiver named in the suit is not the real party in interest. As noted by the Fifth Circuit, the Alabama receivership court approved a bulk reinsurance agreement of Empire with Protective Life Insurance Company. Pet. App. 1. As noted by petitioner, "[i]t is Protective, and Protective alone, that the judgment will enrich." Pet. at 26. In addition to Protective gaining the windfall, *amicus* notes that the attorney for respondent, Mr. William Wright, a Texas citizen, has an employment contract dated November 13, 1972, filed in the Alabama receivership court granting him an hourly rate *plus* a one-third interest in the recovery from this action. Although denominated a "contingent fee," there was no financial risk to him since he was and is being compensated from a $2 million fund set aside from the assets of Mr. Moody's allegedly insolvent company. In reality, the respondent assigned away all his interest in this case, and is nothing more than a conduit for a windfall going to Protective Life and Mr. Wright. The nondiverse party is Mr. Wright of Texas. *See Anderson v. Watt*, 138 U.S. 694 (1891); *American Foundation, Inc. v. Mountain Lake Corp.*, 454 F.2d 200 (5th Cir. 1972).

Consequently, *amicus* submits that the lower court lacks diversity jurisdiction.

B. No Pendent Jurisdiction

At the trial court level, petitioner challenged the propriety of the district court's exercise of pendent jurisdiction. Motion to Dismiss the Original Complaint at 15 (filed Sept. 30, 1975). The subsequent judgment by the district court never clarified the issue of whether it was exercising pendent jurisdiction. Mr. Moody's brief filed at the appellate level in support of his motion to vacate the district judgment at 12-17 provides further compelling reasons why the exercise of pendent jurisdiction, if it indeed were exercised, was improper. This is-

sue was never waived either at the trial or appellate level by petitioner and merits this Court's review to ensure that federal jurisdiction is being properly involved in such a case as this with its significant impact.

Without discussing this issue at length, *amicus* notes that the essence of the argument is that no real federal securities 10b-5 claim was properly made, since one or more elements of the claim are necessarily lacking. Indeed, the Fifth Circuit's opinion is grounded only on liability under the state claims. For example, if as it appears, the proximate cause of the damages was the acquisition program by Empire, then fraudulent Section 10b-5 acts complained of were the cause of the injury, which is too remote and insufficient to find liability. If proper causation did exist, the element of reliance disappears since petitioner could hardly defraud himself or his alter ego, Empire. If the minority shareholders stand in the place of the corporation, then the statute of limitations bars a 10b-5 claim since the last acquisition program took place over four years before this action was filed.

Even if a substantial 10b-5 claim were presented, pendent jurisdiction was improper since the common law fraud claims were, as even admitted by respondent below, "virtually identical" to the facts of the 10b-5 claim. *Amicus* submits that it is an improper use of Federal pendent jurisdiction to use the identical operative facts to serve the simultaneous purpose of supporting common law and federal claims. *See Santa Fe Industries v. Green*, 430 U.S. 462, 479 (1977); *Herpick v. Wallace*, 430 F.2d 792, 809 (5th Cir. 1970).

The exercise of pendent jurisdiction similarly violates the principle, as noted in the first part of this brief, that the valuation of the asset in question which was properly made by the appropriate state official should not be subject to this novel and belated collateral attack.

CONCLUSION

For the foregoing reasons and those stated in the Petition, *amicus* submits that this case especially warrants the granting of the petition for a writ of certiorari.

Respectfully submitted,

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